United Nations DP/2009/3

Executive Board of the United Nations Development Programme and of the United Nations Population Fund

Distr.: General
2 December 2008

Original: English

First regular session 2009
19 to 22 January 2009, New York
Item 2 of the provisional agenda
Financial, budgetary and administrative matters

Cost classification in UNDP*

Summary

In response to several recent decisions of the Executive Board, the present report contains an initial conceptual framework and a broad 'road map' to initiate discussions towards a more transparent, results-oriented and coherent cost classification system in UNDP. A number of subsequent reviews and analyses will be undertaken, and further elaborations provided in support of the broad concepts presented here. In parallel, UNDP plans to hold a series of informal meetings with Board members over the months leading up to the second regular session 2009, at which the biennial support budget, 2010-2011, and the mid-term review of the programming arrangements, 2008-2011, will be formally considered by the Board.

08-63067 (E) 191208

Contents

Chapter		*Page*
I.	Background	3
II.	Cost classification	3
	A. Conceptual framework	3
	B. The 'road map'	4
Annex		11
	Harmonized cost definitions	11

I. Background

1. This report is presented in response to Executive Board decision 2007/33 (paragraph 7) on proposals on programming arrangements for 2008-2011, and decision 2008/1 (paragraph 8) on the UNDP biennial support budget, 2008-2009. The report provides an initial conceptual framework and broad 'road map' for realigning cost classification of activities within the overall UNDP resource plan[1] as funded from the programming arrangements and the biennial support budget. It also serves as a prerequisite for subsequent discussions on the base structure of UNDP.

2. This report is also presented for the initial consideration of the Executive Board within the context of the commencement of preparations for discussions on the biennial support budget, 2010-2011, and the mid-term review of the programming arrangements, 2008-2011. Both of these items are scheduled for formal consideration by the Executive Board at its second regular session in September 2009.

II. Cost classification

A. Conceptual framework

3. The responsibilities of UNDP as a leading development organization of the United Nations system have evolved over the past decade to respond more effectively to the demands of programme countries, resolutions of the General Assembly and decisions of the Executive Board. Accordingly, UNDP fulfils two mutually reinforcing roles: (a) it supports the coordination, efficiency and effectiveness of the United Nations system as a whole at the country level; and (b) it provides policy and technical support by working on and advocating for the multi-sectoral challenges of poverty reduction, democratic governance, crisis prevention and recovery, and environment and sustainable development.

4. In view of the above, UNDP has been directed to strengthen its role in supporting the coordination, efficiency and effectiveness of the United Nations system as a whole at the country level. In conjunction, it continues to fund development projects, while responding to an ever-increasing demand for advocacy, policy services and technical support from programme countries to meet the multi-sectoral challenges identified above.

5. The activities of UNDP are articulated in its business model, which supports the dynamic responsibilities delegated to UNDP by the General Assembly, reflected most recently in General Assembly resolution 62/208. The business model provides the framework for UNDP support to programme countries towards the fulfillment of their national development strategies. It encompasses support to the coordination, advocacy and development services of the United Nations development system, and to the underlying management functions that facilitate their delivery.

6. The strategic plan, 2008-2011, sets the overall direction for UNDP operations in support of programme countries as approved by the Executive Board. The strategic plan rests upon four pillars, which are derived from the business model and in principle drive the mobilization and allocation of regular and other resources. They support programme activities; ensure effective programme implementation; facilitate United Nations development coordination; and support management functions.

[1] Cross reference to DP/2008/3, table 1.

7. The UNDP resource plan is an integrated financial resources framework covering development and management activities – including UNDP development coordination activities – funded from regular and other resources. Two distinct regular resources funding frameworks are considered separately by the Executive Board: the programming arrangements framework, 2008-2011; and the biennial support budget, 2008-2009.

8. In principle, the programming arrangements framework should support programme activities, ensure effective programme implementation and facilitate United Nations development coordination, while the biennial support budget should support management functions. In practice, the programming arrangements framework does contain all programme activities. However, it does not sufficiently differentiate programme activities from programme implementation activities, nor does it contain all the programme implementation and United Nations development coordination activities. While the biennial support budget now incorporates results-based budgeting, it remains separate and distinct from the programming arrangements framework, and uses cost classifications more reflective of a funding organization. Thus the two funding frameworks, and, more importantly, the cost classifications within them, are not fully responsive and supportive of the evolving responsibilities of UNDP, especially when viewed in the context of the demand-driven and results-oriented environment in which UNDP operates.

9. As a result, an artificial divide has been created, and continues to exist, between activities funded under the programming arrangements framework and those funded under the biennial support budget. For example, in response to a programme country request to 'receive policy advice', UNDP hires a consultant under the programming arrangements to provide advice on an environmental issue. The associated expenditure would be recorded as a development expense. In contrast, if the same advice for the same activity were provided by a specialized UNDP national officer in the country office, it would be charged to the biennial support budget as a management expense.

10. In addressing this artificial divide, UNDP needs to further rationalize the responsibilities, functions and activities reflected in its funding frameworks and cost classification system. In so doing, it needs to align them with the business model and the multi sectoral challenges and targeted results for 2008-2011 approved for implementation by the Executive Board. Accordingly, a more transparent and responsive cost classification system, coupled with more flexible funding mechanisms, is required. This is particularly important for strengthening results-based management, ensuring coherent attribution of costs and enhancing resources mobilization.

11. A joint consultancy was commissioned by UNDP, UNICEF and UNFPA in mid-2008 to assess the degree of harmonization in cost classification among the three organizations. The harmonized cost definitions agreed to by UNDP, UNICEF and UNFPA were reviewed and found still applicable. Those definitions, and a more detailed discussion of this subject, can be found in the annex to the present report, 'Harmonized cost definitions'.

B. The 'road map'

12. Three guiding principles support the underlying need for a transparent, strategic and fully aligned cost classification system in UNDP:

(a) transparent identification and attribution of costs;

(b) rationalization and simplification of cost classification groupings in line with more realistic and responsive funding frameworks; and

(c) alignment of cost classifications and funding frameworks with the business model and the strategic plan;

13. Specifically, with the adoption of a more strategic, coherent and harmonized business approach across the United Nations system, it is critical that underlying costs be clearly defined and transparently linked to organizational objectives. This should enhance results-based reporting, balance service demand with supply requirements, improve accountability, facilitate decision-making, and foster comparability.

14. The funding frameworks contain the resource facilities (programme lines and results-based budgeting functions) which in principle facilitate the delivery of planned results, and in which costs are classified. Therefore it is imperative to have rational, simple cost classification groupings in place to ensure that funding frameworks are realistic and responsive. In that regard, the two broad cost groupings that now exist – development and management – remain relevant. However, the classification of costs between and within the two funding frameworks requires further analysis and review to ensure that the demands for enhanced cost attribution and increased transparency are met. A third broad cost classification category is considered, to capture special-purpose activities (see paragraphs 19- 22, below).

15. The alignment of cost classifications and funding frameworks with the current focus of the business model and direction of the strategic plan is equally important. Enhanced alignment should further strengthen the ability to allocate resources in a clearer, more demand-driven manner, in line with planned organizational priorities and the functions and activities required to achieve them. This should permit an optimal allocation of resources to development activities, while ensuring that the requisite amount of sustainable resources is allocated to management activities.

16. UNDP is considering a conceptual framework for classifying costs along the three broad groupings discussed above – *development, management, and special purpose.* Consideration will also be given to the formulation of a more integrated funding framework into which those costs could be classified.

17. Development costs could lend themselves to further classification within three major subcategories, based on groupings of similar activities and functions. Those are: *programmes; programme effectiveness activities; and United Nations development coordination activities*. They are briefly described below.

(a) *programmes* – representing the resource facilities and costs classified therein available to fund country, regional and global programmes and projects in the four UNDP areas of focus. The resource facilities (programme lines) contained in the programming arrangements framework fund development programmes and projects at the country (TRAC[2]-1/2 and TRAC-3), global (global programme) and regional (regional programme) levels.

(b) *programme effectiveness activities* – representing UNDP inputs of a policy advisory, normative or technical nature which are needed to achieve the objectives of programmes or projects in the four UNDP areas of focus. These activities are considered integral to achieving planned results. This category would include the costs of policy advisory services and normative work, as well as advocacy and technical support costs incurred during programme or project identification, formulation, management and implementation.

(c) *United Nations development coordination activities* – representing the inputs needed to support the coordination of development activities of the United Nations system. These would include representation and leadership in the United Nations system and all costs associated with the resident coordinator function; strategic coordination of United Nations country teams; formulation of United Nations development assistance frameworks and joint programmes; partnership support to and resource mobilization on behalf of the United Nations system; public information,

[2] Target for resource assignment from the core

advocacy and monitoring progress towards the Millennium Development Goals; and common and shared services.

18. *Management activities* represent the UNDP functions and activities required to ensure the delivery of programmes, programme effectiveness activities and United Nations development coordination activities. These would include: executive leadership and direction; corporate oversight and accountability; compliance with statutory obligations; and effective human and financial resources management.

19. Special-purpose activities could form a third broad cost classification category, given their cross-cutting nature and the material amounts involved. Three major subcategories could be considered: United Nations-mandated security costs; after-service health insurance costs; and capital investment costs.

20. *United Nations-mandated security costs* emanate from UNDP participation in the approved package of global measures under implementation by the United Nations Department of Safety and Security. These measures include the United Nations field security coordination programme and compliance with minimum operational security standards at the country-office and headquarters levels. After-service health insurance costs are the costs for health-care benefits accruing to eligible employees upon retirement. Significant costs, associated with the unfunded liability arising from actuarial valuations of projected after-service health insurance costs, have been identified and are accrued for annually.

21. The treatment of capital investment costs as a separate special-purpose cost could serve to further increase transparency through the separation of capital costs from operational (management) costs. This should allow for clearer lines of accountability within the organization, at the same time allowing governing bodies to recognize their accountability for ensuring the availability of resources to fund such activities. It should also enhance strategic planning through long-term prioritization of capital investment requirements, and assist in risk management by mitigating the need to meet sudden, unplanned funding demands. Separate budgeting for capital costs is aligned with IPSAS principles of accruals and depreciation, and in line with best practices.

22. UNDP is currently leading a High-level Committee on Management/Finance Board Network-sponsored working group on capital budgeting, the main objective of which is to develop a broad, strategic and inclusive conceptual framework for the introduction of harmonized capital budgeting into the United Nations system. Issues relating to financing mechanisms and the revision of financial regulations and rules have been raised. This is especially pertinent because at present the financial regulations and rules preclude the borrowing of funds and the construction of buildings, both of which are areas of potential interest to UNDP.

23. In conclusion, the business model and the strategic plan – and the resource frameworks and cost classification system which underpin them – are the key to the future relevance and sustainability of UNDP. As broadly presented herein, a more transparent cost classification system is required to attribute costs, respond to the demand-driven needs of programme countries and enhance results-based management. This approach should result in a more optimal allocation of resources to meet the myriad funding priorities of UNDP, including a longer-term view of the need for sustainability. The broad concepts set forth in the present report are intended to initiate the discussions that will bring about this result.

Annex. Harmonized cost definitions

24. The harmonized cost definitions agreed upon by UNDP, UNFPA and UNICEF are:

(a) *direct costs* – all costs that are incurred for and can be traced in full to the activities, projects and programmes of an organization in fulfillment of its mandate;

(b) *fixed indirect costs* – all costs that are incurred by the organization regardless of the scope and level of its activities, and which cannot be traced unequivocally to specific activities, projects or programmes;

(c) *variable indirect costs* – all costs that are incurred by the organization as a function and in support of its activities, projects and programmes, and which cannot be traced unequivocally to specific activities, projects or programmes.

25. Those harmonized definitions are largely aligned with the Joint Inspection Unit (JIU) definitions as reflected in JIU/REP/2002/3. The one area where additional clarity is provided relates to the treatment of direct project and programme costs. In that regard, it is significant to note that the JIU classifies costs relating to programme and project formulation, management and implementation activities, including those of an advisory nature, as direct costs. For the purposes of this report, such activities are accorded similar treatment and are referred to collectively as 'programme effectiveness costs'.

26. The application of the above definitions facilitates the classification of costs across the three organizations as: 'direct' development costs (programmes, programme effectiveness, and in the case of UNDP, United Nations development coordination); and as 'fixed indirect' or 'variable indirect' management costs.

27. In general the classification of costs between development and management are harmonized among the three organizations, with the notable exception of programme effectiveness related costs. In view of the differing organizational mandates, total harmonization of operations, including the classification of costs, is not a realistic or desirable goal. Further harmonization could nevertheless be considered in three areas:

(a) classification of costs between development and management, especially with respect to programme effectiveness related costs;

(b) classification of costs within the management functions;

(c) classification of costs within the management functions between fixed indirect costs and variable indirect costs.

28. To ensure greater harmonization, UNDP intends to continue discussions with partner organizations around definitions and descriptions. The focus will be on achieving greater consistency in the activities and related costs included under each function and ensuring consistency in the classification of costs between management and development, especially with respect to programme effectiveness functions. Similarly, discussions will continue on consistency in the classification of management costs as 'fixed indirect' or 'variable indirect' costs.